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As I sell

THE ABC's OF THE FUTURE OF RESIDENTIAL PROPERTIES

THE direction which the selling price of single-family residences will take is of greater interest to more people than any other real estate factor. Seventy percent of all dwelling units in the United States are single-family residences. Sixty-nine percent of total mortgage debt outstanding is on one- to four-family dwellings. Savings and loan associations have 93 percent of their mortgages on this type of building. Savings banks are also heavily involved, as are life insurance companies and commercial banks, to a lesser extent. Whether these values go up or down is of primary interest to the home owner and the mortgage lender.

It seems to me that it is not too difficult at the present time to guess the trend in selling price of this type of property during the next 10 years.

Let us oversimplify the problem. We all know that there are many factors which affect the selling prices of residences. Listing a few of the more important would include such things as financing terms, interest rates, replacement cost new of the building, changes in land values, changes in quality of the neighborhood (including such things as the infiltration of different economic, racial or national groups), adequate maintenance and repair, changes in the prosperity of the community, increases and decreases in residential vacancy, rate of growth of a community, changes in accessibility, etc.

During the past third of a century our organization has studied each of these factors and its effects on values, and undoubtedly they all have had their effects. The great changes, however, that have come about have been the result of only one of these factors. The change in replacement cost new is primarily responsible for all of the major movements in the selling prices of new and existing buildings. If the cost of producing a new building goes up by a sizable percentage, there will be a tendency for all existing useful buildings to take on a large part of this increase. If, on the other hand, replacement cost new drops by a sizable percentage, there will be a tendency for all useful buildings to drop by at least this great a percentage.

If I would forecast, then, the selling prices of existing single-family residences during the next 10 years, I would focus my attention primarily on the probable level of replacement cost during this period.

The chart on the page opposite shows the variation in selling price of a single-family residence on a suitable lot, both for a brand new building and for an older building. Clearly, the reason why the values of existing buildings practically doubled from 1914 to 1926 was the fact that the cost of building a new building on a suitable lot during this period practically doubled. The reason that from 1928 to 1932 the cost of an existing house was more than halved was the drop in replacement cost which occurred from 1924 to 1932. The older house declined more than replacement cost new, as generally occurs in periods of this sort because in times of stress and lagging real estate sales the public gives more consideration to depreciation and obsolescence than it does in active periods when housing shortages occur. The reason why the average residence increased from \$5,500 in 1940 to \$18,000 in 1958 was that replacement cost of a somewhat similar building increased from \$8,000 in 1938 to almost \$24,000 in 1958. The drop in the selling price of existing houses from 1958 to the present is due principally to the drop in replacement cost in the last two years.

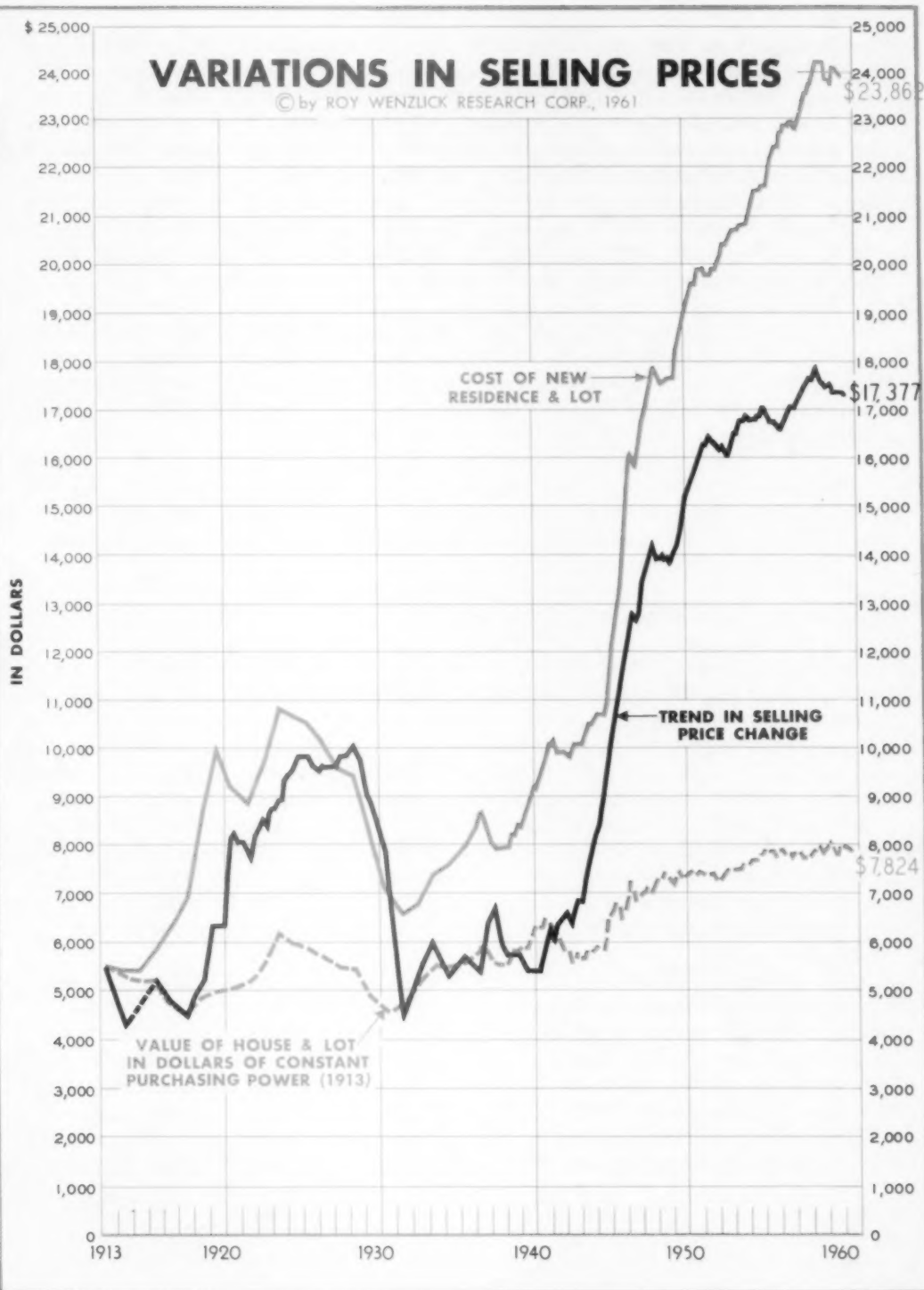
In order, therefore, to forecast changes in the selling prices of existing buildings it is necessary to forecast changes in replacement cost new. If the cost of building new buildings rises by a considerable percentage, the values of all existing useful buildings will rise.

What will happen to replacement cost new?

It seems to me that developed building sites will not come down in price and may rise still further. The cost of development with streets and utilities will continue to increase. I do not expect the prices of raw land to rise as I think the great rises we have had have been due to a large extent to the fact that considerable areas were held off the market for speculation. This was made possible in many communities by the fact that land was assessed for tax purposes on its actual use rather than on its fair market value for its highest and best use. I think there is a trend throughout the United States to change this assessment practice, and I think that more and more of this raw land will carry assessments much higher than those of the past. This should bring on to the market some land which otherwise would be held for a long-term rise.*

The red dotted line on the chart shows the fluctuations in replacement cost new which would have occurred had we had a dollar of constant purchasing power during the entire span of this chart. If this had been true, our \$5,500 house and lot would sell today for less than \$8,000 in place of more than \$24,000. Since 1941 the change in selling price, in constant dollars, has been less than \$1,500, while the change in replacement cost new has been more than \$15,000. I have often said that the big real estate boom we have gone through during the past 20 years has been illusory. Real estate sold for more because

*See The Real Estate Analyst, April 17, 1961, As I See Bulletin, "The Future of Raw Land."



the selling price was measured in dollars which had lost a large part of their value. It wasn't primarily the housing shortage, which reached its peak in 1947, that was responsible for this rise, although it contributed slightly for a while, nor is it primarily the rise in vacancy which is responsible at the present time for the drop in selling prices of existing houses. The attempt to hold the line on inflation stopped the upward movement of replacement cost new and, accordingly, started a slight downward movement in the values of existing properties.

If we are to forecast the changes in replacement cost new, it seems to me that this chart would indicate the following.

Replacement cost new in constant dollars (the red dotted line) will probably show very little upward or downward movement during the next 10 years. I will be greatly surprised if this figure varies by as much as \$1,000. Replacement cost new in current dollars will depend primarily in the future, as it has in the past, on the amount of inflation which we allow in our economic system.

The amount of inflation will depend primarily on the expansion of currency and credit. The amount of currency and credit will depend primarily on the necessity of inflationary policies on the part of the Federal Government in order to finance the deficits made necessary by the intensification of the Cold War, and by the further expansion of welfare activities. I will be surprised if in the next 10 years the amount of inflation does not average better than 2 percent per year. In other words, it seems to me that the very minimum we could expect in price levels 10 years from now would be 20 percent above the present level. The maximum may exceed this by many times.

The reason the ownership of its own home forms a good inflation hedge for the average family is, first, the fact that a single-family residence is a long-lived commodity. I have just returned from a trip through Vermont, and I was quite interested in the architecture of many of the houses, which indicated to me that many of them had been built 80 or more years ago. They were still in good repair and well maintained. Certainly any policy of depreciating these houses at the rate of 2 or $2\frac{1}{2}$ percent a year, had it been followed, would have resulted in a negative value long ago, and the houses I saw had a very positive value.

It seems to me that the depreciation of the dollar during the next 10 years will exceed the depreciation rate on residential buildings and, accordingly, I believe that the average well-maintained residence in a well-maintained neighborhood will sell for more 10 years from now than it does now, in spite of the additional accrued depreciation.



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